relief is warranted upon satisfaction of the Phase II triggers within an MSA, even though such relief might lead to higher rates for access to some parts of an MSA that lack a competitive alternative, for several reasons. First, the customers for the services we address in this section are IXCs and large businesses, not residential or small business end users. These large and sophisticated customers generate significant revenues for the incumbent and are not without bargaining power with respect to the incumbent.

143. Second, delaying Phase II regulatory relief until access customers have a competitive alternative for access to each and every end user might give competitors the ability to "game the system." In other words, competitors might be able to prevent an incumbent from obtaining pricing flexibility in an MSA simply by choosing not to enter certain parts of that MSA or to serve certain customers. We will not distort the operation of the market in this manner.

144. Finally, because regulation is not an exact science,[374] we cannot time the grant of regulatory relief to coincide precisely with the advent of competitive alternatives for access to each individual end user. We conclude that the costs of delaying regulatory relief outweigh the potential costs of granting it before IXCs have a competitive alternative for each and every end user. The Commission has determined on several occasions that retaining regulations longer than necessary is contrary to the public interest. Almost 20 years ago, the Commission determined that regulation imposes costs on common carriers and the public, and that a regulation should be eliminated when its costs outweigh its benefits.[375] More recently, the Commission recognized that retaining tariffing requirements for non-dominant IXCs imposes costs in the form of a less efficient market.[376] In Section III of this Order, we conclude that the new service rules currently in effect limit incumbents' incentives to innovate. The Part 69 rate structure can impose costs on an incumbent LEC by limiting its ability to develop rate structures in response to market forces. Thus, retaining the Part 69 rate structure imposes costs on society by perpetuating inefficiencies in the market for interstate access services. The triggers we adopt for Phase II flexibility are sufficient to ensure that incumbent LECs cannot exercise any remaining monopoly power indefinitely. If an incumbent LEC charges an unreasonably high rate for access to an area that lacks a competitive alternative, that rate will induce competitive entry, and that entry will in turn

[374] *United States v. FCC*, 707 F.2d at 618.

[375] Policy and Rules Concerning Rates for Competitive Common Carrier Services and Facilities Authorizations Therefor, CC Docket No. 79-252, First Report and Order, 85 FCC 2d 1, 3 (1980) (*Competitive Carrier First Report and Order*). The Court later overturned this Order, but only because the Commission did not have authority under the Communications Act at that time to forbear from regulation, not because it erred in determining that the costs of regulation can outweigh its benefits. *See* MCI v. FCC, 765 F.2d 1186, 1195-96 (D.C. Cir. 1985); AT&T v. FCC, 978 F.2d 727, 736 (D.C. Cir. 1992).

[376] Policy and Rules Concerning the Interstate, Interexchange Marketplace, CC Docket No. 96-61, Second Report and Order, 11 FCC Rcd 20730, 20762-63 (1996).

drive rates down. Accordingly, we will not delay Phase II regulatory relief until access customers have a competitive alternative for access to every end user.

145. As we did in Phase I, we establish different triggers for (1) special access services (other than channel terminations) and dedicated transport services, and (2) channel terminations. In this section of the Order, we adopt triggers for each of these services and adopt specific forms of regulatory relief for Phase II. In the Notice accompanying this Order, we invite interested parties to comment on Phase II triggers for other switched access services.

b. Phase II Triggers

146. We note above that the regulatory relief proposed by Ameritech and Bell Atlantic for "Phase II" is analogous to our Phase I relief. Here, we find that Ameritech's and Bell Atlantic's Phase III proposals are analogous to the Phase II relief we adopt here.[377] Therefore, we rely in part on the record developed in response to Bell Atlantic's and Ameritech's proposals in developing our Phase II triggers. Bell Atlantic proposes granting relief when competitors have collocated facilities, purchased UNEs, or installed their own facilities in 75 percent of the wire centers in the market area.[378] Ameritech recommends granting relief when competitors have collocated in wire centers serving 75 percent of the demand in a market area, measured on a DS1-equivalent basis.[379]

147. Access customers must have competitive alternatives throughout most of an MSA before we can grant Phase II regulatory relief to an incumbent LEC. The Ameritech and Bell Atlantic proposals recognize that our Phase II triggers must be high enough to ensure that competitive alternatives for the services at issue exist in the area for which flexibility is granted. The triggers we adopt, however, differ from those recommended by these incumbent LECs in two respects: as in Phase I, (1) we base our Phase II triggers on collocation in either a certain percentage of wire centers in an MSA, or in wire centers generating a certain percentage of the revenues for the services at issue in an MSA; and (2) we conclude that different services warrant different thresholds.

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[377] In addition to all the forms of regulatory relief we grant immediately in Sections III and V of this Order and that we will grant upon satisfaction of Phase I triggers, in Phase II, we will (1) relax our Part 69 rate structure rules, and (2) permit price cap LECs to offer access services completely outside of price cap regulation. Ameritech and Bell Atlantic recommend removing services from price cap regulation upon demonstration that an incumbent LEC has met their Phase III criteria. Ameritech *ex parte* statement of June 5, 1998, at 3; Bell Atlantic *ex parte* statement of April 27, 1998, at 22. USTA also recommends removing services from price caps upon its Phase III showing, and recommends eliminating Part 69 rate structure requirements upon a Phase I showing. USTA Oct. 26 Comments at Att. E.

[378] Bell Atlantic *ex parte* statement of April 27, 1998, at 21.

[379] Ameritech *ex parte* statement of June 5, 1998, at 2.

148. We determined in our Phase I analysis above that evidence of collocation may underestimate the extent of competitive facilities within a wire center, because it fails to account for the presence of competitors that have wholly bypassed incumbent LEC facilities. For this reason, we adopt a threshold lower than the 75 percent recommended by Ameritech and Bell Atlantic. For dedicated transport, and for special access services other than channel terminations, we grant Phase II pricing flexibility to incumbent LECs that demonstrate that competitors have collocated in 50 percent of an incumbent LEC's wire centers in the MSA at issue. SBC has shown that competitors have collocated in 51 percent of its wire centers in the San Diego MSA.[380] According to SBC, competitors' networks in this MSA comprise at least 1150 route miles, and there are more than 360 buildings on those networks.[381] Similarly, competitors have collocated in 58 percent of SBC's wire centers in the Los Angeles MSA.[382] SBC submits that competitors' networks in this MSA comprise more than 2530 route miles, and there are more than 950 buildings on those networks.[383] We explain above that establishing an operational collocation arrangement requires considerable time and expense.[384] This evidence suggests that collocation in 50 percent of an incumbent LEC's wire centers corresponds to considerable investment by competitors in transmission facilities and the ability of competitors to serve customers in a large number of buildings.

149. As we explain in our Phase I discussion, a few wire centers may account for a disproportionate share of revenues for a particular service. For this reason, we also will grant Phase II pricing flexibility for these services upon a demonstration that competitors have collocated in wire centers accounting for 65 percent of the incumbent LEC's revenues from those services in an MSA. Similarly, we will grant Phase II pricing flexibility for channel terminations between an IXC POP and a LEC serving wire center when an incumbent demonstrates that competitors have collocated in 50 percent of its wire centers in an MSA, or in wire centers accounting for 65 percent of the incumbent's revenue for this service. As we explained in our discussion of Phase I triggers above, these services carry traffic between points of high traffic concentration and therefore warrant lower triggers than those we adopt for channel terminations between a LEC end office and a customer premises.

150. We adopt higher thresholds for channel terminations between an incumbent LEC's end office and customer premises, for the reasons we offered in our Phase I analysis. For these channel terminations, Phase II relief is available to LECs that demonstrate that

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[380] SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 2.

[381] SBC Forbearance Petition, Att. A at 10.

[382] SBC Reply in SBC Forbearance Proceeding, CC Docket No. 98-227, Att. 2. For purposes of its forbearance petition, SBC treats the Long Beach and Orange County MSAs as one MSA.

[383] SBC Forbearance Petition, Att. A at 10.

[384] Section VI.C.2, *supra*.

competitors have collocated in 65 percent of the incumbent LEC's wire centers in the MSA at issue, or in wire centers accounting for 85 percent of the incumbent's revenues from those services in that MSA. Because these services do not carry traffic between points of high traffic concentration, and because the collocated competitors still rely on incumbent LEC facilities to reach the end user, we find that higher thresholds are warranted.

151. MCI argues that price cap LECs should be permitted Phase II regulatory relief, such as removal of services from price cap regulation, only when those LECs are "non-dominant," *i.e.*, no longer have market power in the provision of the services at issue.[385] We conclude that the Phase II regulatory relief we grant below is warranted when competitors have established a significant market presence in an MSA, and we need not require a showing of non-dominance. Upon a Phase II showing, we will not grant incumbent LECs all the regulatory relief we afford to non-dominant carriers. Specifically, incumbent LECs in Phase II are still required to file generally available tariffs, while non-dominant LECs and CAPs are permitted, but not required, to file tariffs.[386] Furthermore, our relief is limited to certain services and certain areas, and will be granted only upon satisfaction of the triggers we adopt here. Thus, Phase II relief is not tantamount to non-dominant treatment.

152. In the *Interexchange Competition Order*, the Commission allowed AT&T to remove some interexchange services from price cap regulation based on a finding of "substantial competition," but it based that finding on a more detailed analysis than the Phase II triggers we adopt here, including an examination of, *inter alia*, demand and supply elasticities, pricing behavior, and market share.[387] We conclude that this detailed substantial competition test is not warranted for special access and dedicated transport services because we grant incumbent LECs pricing flexibility only on a MSA-by-MSA basis, while the Commission granted AT&T pricing flexibility on a nationwide basis. Furthermore, the administrative burdens of a detailed substantial competition test are magnified when done on an MSA-by-MSA basis, and we believe our collocation-based triggers are sufficient to ensure that we do not grant pricing flexibility prematurely. Accordingly, we will rely on collocation-based triggers to indicate when competitors have established a significant market presence that warrants Phase II relief for special access and dedicated transport services.[388]

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[385] MCI Oct. 26 Comments at 48.

[386] *See* Hyperion Telecommunications, Inc. Petition Requesting Forbearance, Memorandum Opinion and Order and Notice of Proposed Rulemaking, 12 FCC Rcd 8596, 8611-12 (1997).

[387] *See Interexchange Competition Order*, 6 FCC Rcd at 5887-93.

[388] We seek comment on Phase II relief for common line and traffic-sensitive services in the accompanying Notice.

c. Phase II Relief

153. Upon satisfaction of the Phase II triggers we adopt above for special access and dedicated transport services, we will no longer require price cap LECs to comply with our Part 69 rate structure rules or Part 61 price cap rules with respect to those services within an MSA. An incumbent LEC should be permitted to remove services from price cap regulation when that LEC's competitors have established a significant market presence in the provision of those services.[389] A significant market presence in an MSA ensures that the incumbent will not be able to exploit any monopoly power for a sustained period. We will, however, continue to require LECs to maintain generally available tariffs, but we will permit them to file such tariffs on one day's notice. In this section, we explain why we conclude that these two forms of relief are warranted upon satisfaction of the Phase II triggers.

154. Currently, Part 69 of the Commission's rules prescribes a rate structure for all switched access services, including dedicated transport. USTA recommends eliminating the Part 69 rate structure as a form of regulatory relief.[390] In addition, in Section III above, we eliminate rate structure requirements for new services. We agree that elimination of our Part 69 rate structure rules for existing dedicated transport services is warranted, but not until the incumbent LEC meets our Phase II requirements. As explained in more detail in Section VIII.C. below, a rate structure can create implicit subsidies if it does not reflect accurately the manner in which incumbent LECs incur the costs of providing a service. Therefore, rate structure rules are necessary in the absence of a significant market presence by competitors. Once competitors have established a significant market presence in an MSA, however, we believe it is no longer necessary to impose efficient rate structures on incumbent LECs. Therefore, we will eliminate our rate structure rules for particular services once an incumbent LEC demonstrates the development of a significant market presence by competitors for those services by satisfying the Phase II trigger. Retaining our price cap and rate structure rules until LECs are non-dominant is unwarranted because doing so would delay the action of competition in setting efficient rate levels and rate structures.

155. We recognize that the regulatory relief we grant upon a Phase II showing may enable incumbent LECs to increase access rates for some customers. We conclude that this relief nonetheless is warranted upon a Phase II showing for two reasons. First, some access rate increases may be warranted, because our rules may have required incumbent LECs to price access services below cost in certain areas. Second, we find that a Phase II showing is sufficient evidence that competitors' market presences have become significant, and that the public interest is better served by permitting market forces to govern the rates for the access services at this point. In addition, we note that these services generally are purchased by

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[389] In the *LEC Price Cap Order*, the Commission explained that it is unnecessary to extend the efficiency incentives of price cap regulation to services offered on a "contract-type basis." *LEC Price Cap Order*, 5 FCC Rcd at 6810.

[390] USTA Oct. 26 Comments, Att. E.

IXCs, not individual end users. IXCs are sophisticated purchasers of telecommunications services, fully capable of finding competitive alternatives where they exist and determining which competitor can best meet their needs.

156. We decline to adopt any other Phase II regulatory relief proposed in the *Access Reform NPRM*. Two of those proposals, elimination of price cap service categories[391] and consolidation of price cap baskets,[392] are not relevant because Phase II relief removes services from price cap regulation.

157. The *Access Reform NPRM* also proposed allowing incumbent LECs to charge IXCs different rates for access to different classes of end user.[393] Ameritech argues that class-of-customer pricing would enable incumbent LECs to respond to competition.[394] We find that the pricing flexibility we grant in Phase I and Phase II is sufficient to enable incumbent LECs to respond to competition. Bell Atlantic argues that class-of-customer pricing is simply another form of deaveraging.[395] We grant price cap LECs considerable flexibility to deaverage their rates in Section V of this Order, and Bell Atlantic does not explain why deaveraging by class of customer is necessary to enable incumbent LECs to respond to competition. Thus, the record does not provide a basis for granting this relief.

D. Price Cap Issues

1. Revision of Price Cap Indices

158. We have determined that no adjustment to price cap LECs' PCIs is warranted when a LEC removes demand associated with services offered pursuant to contract tariff from a price cap basket, or when an entire service is removed from price cap regulation pursuant to a Phase II showing. When the Commission permitted AT&T to remove commercial long distance services from price cap regulation, it did not require AT&T to make any exogenous cost adjustment to the PCI for the basket from which those services were removed.[396] Specifically, the Commission found that the removal of an individual service from a basket

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[391] *Access Reform NPRM*, 11 FCC Rcd at 21445.

[392] *Id.* at 21447-48.

[393] Specifically, the Commission proposed allowing incumbent LECs to charge an IXC different rates for local switching and transport services based on the class of end user to which the IXC provides long distance service. *Id.* at 21445-46.

[394] Ameritech Comments at 46.

[395] BA/NYNEX Comments at 51. *See also* USTA Comments at 28.

[396] Revisions to Price Cap Rules for AT&T Corp., CC Docket No. 93-197, Report and Order, 10 FCC Rcd 3009, 3019 (1995) (*Commercial Services Order*).

has no effect on the PCI, and it affects the API only by altering the base period revenue weights of the services remaining in the basket at the time a carrier revises some other rate in that basket.[397] Thus, removing individual services from price cap regulation has only a *de minimis* effect on the headroom for the services remaining in the basket.[398]

159. In accordance with this precedent, we do not require incumbent LECs to make any exogenous adjustment to their PCIs to reflect the removal of demand associated with contract tariff services from price cap regulation. Although the Commission did require a "recalibration" of AT&T's PCIs when other services were removed from price cap regulation,[399] we find that the recalibration required by those Orders is not needed for removal of contract tariff demand. In those cases, the Commission removed all the services except one service category from the basket in question. Because the service band indices (SBIs) were designed to limit cross-subsidization between different types of services within a basket, and there is no danger of cross-subsidization when there is only one service category remaining in the basket, the Commission recalibrated AT&T's PCIs and APIs to eliminate the SBI for the remaining basket without affecting the headroom AT&T had previously.[400] In the case of the relief we provide here, however, incumbent LECs will remove only some demand for some services from a basket; therefore, we will retain the SBIs, and there is no need for the recalibration we required of AT&T.

2. Low-End Adjustment Mechanism

160. *Background.* In the *LEC Price Cap Order*, the Commission adopted the low-end adjustment mechanism, which permits incumbent LECs earning rates of return less than 10.25 percent in a given year to increase their PCIs to a level that would enable them to earn 10.25 percent.[401] The Commission decided to retain the low-end adjustment mechanism in the *Price Cap Fourth Report and Order*, to prevent confiscatory price cap rates in cases where differences in economic conditions in different price cap LECs' service regions might cause a LEC to earn a confiscatory return in a given tariff year.[402]

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[397] *Commercial Services Order*, 10 FCC Rcd at 3019.

[398] *See also* USTA *ex parte* statement of Jan. 27, 1999; U S West *ex parte* statement of Jan. 28, 1999.

[399] *Interexchange Competition Second Report and Order*, 8 FCC Rcd at 3671 (removal of all services except 800 directory assistance from Basket 2); *AT&T Non-DominantReinitialization Order*, 11 FCC Rcd 1201 (removal of services except international services from Basket 1).

[400] *Interexchange Competition Second Report and Order*, 8 FCC Rcd at 3671; *AT&T Non-Dominant Reinitialization Order*, 11 FCC Rcd at 1201.

[401] *LEC Price Cap Order*, 5 FCC Rcd at 6804.

[402] *See Price Cap Fourth Report and Order*, 12 FCC Rcd at 16691, 16704-05; *Price Cap Performance Review*, 10 FCC Rcd at 9048.

161. In its petition for reconsideration of the *Price Cap Fourth Report and Order*,[403] AT&T questions whether it is reasonable to retain the low-end adjustment mechanism after the elimination of sharing.[404] In this Order, for the reasons discussed below, we partially grant AT&T's petition on this issue. We will consider other issues raised in AT&T's petition, along with other petitions for reconsideration of the *Price Cap Fourth Report and Order*, in a future Order.

162. *Discussion.* We eliminate the low-end adjustment mechanism for price cap LECs that qualify for and elect to exercise either the Phase I or Phase II pricing flexibility we grant in this Order.[405] AT&T argues that the low-end adjustment mechanism blunts efficiency incentives just as sharing does and that, therefore, retaining it is inconsistent with the Commission's decision to eliminate sharing.[406] AT&T also notes that several LECs opposed retention of the low-end adjustment mechanism, and those that supported it did so only as a means to provide "symmetry" to the sharing obligation.[407] AT&T requests that we eliminate the low-end adjustment mechanism or re-introduce sharing.[408]

163. We conclude that we should eliminate the low-end adjustment mechanism once price cap LECs qualify for and choose to exercise either the Phase I or Phase II pricing flexibility we grant in this Order. We agree with AT&T that the low-end adjustment mechanism tends to blunt efficiency incentives. We also conclude that this effect will be exacerbated by removing contract tariff services from price cap regulation, so that retention of the mechanism would be unreasonable for price cap LECs obtaining pricing flexibility. The low-end adjustment mechanism can create undesirable incentives for price cap LECs when

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[403] *Price Cap Fourth Report and Order*, 12 FCC Rcd 16642. For purposes of this Section VI.D.2 of the Order, except as otherwise noted, "Petition" refers to petitions for reconsideration of the *Price Cap Fourth Report and Order* filed July 11, 1997, "Comments" refers to comments filed in response to those petitions on August 18, 1997, and "Reply" refers to replies filed in response to those petitions on September 3, 1997.

[404] AT&T Petition at 13-16. When price cap regulation included sharing obligations, incumbent LECs were required to "share" half or all their earnings above specified rates of return with their access customers through lower PCIs during the following year. *See Price Cap Fourth Report and Order*, 12 FCC Rcd at 16649. The Commission eliminated sharing obligations in the *Price Cap Fourth Report and Order*, in part because the benefits derived from those obligations were reduced by the adoption of an X-Factor based on a more accurate measure of productivity growth and elimination of multiple X-Factor options. As a result, the efficiency-blunting effects of sharing began to outweigh its benefits. *Id.* at 16699-702.

[405] Streamlined treatment of new services, removal of interexchange services from price caps, and geographic deaveraging of rates for services in the trunking basket do not affect a LEC's entitlement to a low-end adjustment.

[406] AT&T Petition at 13-15.

[407] *Id.* at 13-14; AT&T Reply at 6-7.

[408] AT&T Petition at 15-16.

they move some demand for some services out of price cap regulation. The low-end adjustment is a rate-of-return-based mechanism, and it therefore recreates some of the incentives of rate-of-return regulation, although not to the same extent as sharing obligations.[409] Earnings from non-price cap services are currently not considered part of "total interstate earnings"[410] for purposes of calculating low-end adjustments.[411] As a result, price cap LECs must remove the costs of non-price cap services in order to calculate interstate earnings, and they have an incentive to underallocate those costs in order to minimize measured earnings. Currently, this underallocation incentive is not a serious concern, because non-price cap services represent a very small fraction of the price cap LECs' federally tariffed activities, and so the effects of any underallocation are minimal.[412] Once a LEC has removed a significant amount of demand associated with contract tariff offerings from price cap regulation, however, its incentive to underallocate the costs of non-price cap services and the effects of such underallocation will be greater.

164. Our decision to eliminate the low-end adjustment mechanism for parties obtaining pricing flexibility is consistent with a proposal made by the Ad Hoc Telecommunications Users Committee (Ad Hoc) in response to the *Access Reform NPRM*. Ad Hoc argues that incumbent LECs either should be guaranteed a just and reasonable rate of return and recovery of all of their prudent investment, or they should be permitted to pursue market opportunities and maximize their earnings, but not both.[413] Ad Hoc reasons that an incumbent LEC permitted unlimited profits under price cap regulation should not be shielded

[409] The Commission has concluded that sharing obligations severely blunt the efficiency incentives that it sought to create when it adopted price cap regulation, by requiring price cap LECs earning more than certain rates of return to share half or all those earnings with their customers. *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16699; *LEC Price Cap Performance Review*, 10 FCC Rcd at 9045-46. The low-end adjustment mechanism does not blunt efficiency incentives as much as sharing because it guarantees only a 10.25 percent rate of return, and price cap LECs should be able to achieve much greater profits by trying to increase their productivity growth.

[410] In the *LEC Price Cap Reconsideration Order*, the Commission explained that sharing and the low-end adjustment mechanism are based on total interstate earnings rather than basket-by-basket earnings. *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2679-80. *See also LEC Price Cap Order*, 5 FCC Rcd at 6805. The Commission also determined that sharing and the low-end adjustment mechanism should be based on earnings from all services subject to price cap regulation, rather than earnings exclusively from access services. *LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2680-81.

[411] *See LEC Price Cap Reconsideration Order*, 6 FCC Rcd at 2681 n.126. Earnings from services excluded from price cap regulation also are excluded from total interstate earnings for purposes of calculating low-end adjustments. *Id.* at 2681-82.

[412] *LEC Price Cap Order*, 5 FCC Rcd at 6810.

[413] Ad Hoc Comments at 66-69.

from any risk of stranded investment.[414] Alternatively, Ad Hoc argues that an incumbent LEC seeking some stranded investment recovery should be subject to 100 percent sharing obligations for all earning in excess of 50 basis points over the authorized rate of return.[415] Although we decline to reimpose sharing obligations, we agree with Ad Hoc that an incumbent LEC seeking pricing flexibility to compete more vigorously in the marketplace should not be afforded any rate-of-return-based protection from any risk associated with its competitive ventures.[416]

165. We have considered whether it is possible to modify the low-end adjustment mechanism to limit the undesirable incentives discussed above. For example, USTA proposed requiring price cap LECs to maintain records regarding demand for services removed from price cap regulation, but permitting them to keep that information confidential. Under USTA's proposal, a price cap LEC seeking to make a low-end adjustment would be required to re-price its removed service demand at an "average price cap tariff rate."[417] It would be difficult, however, for the Commission or other interested parties to verify that a price cap LEC claiming a low-end adjustment has re-priced its contract tariff demand properly. Specifically, whenever a contract tariff offering is a package of two or more access services, USTA's proposal requires the incumbent to allocate the contract rate among the services in the package. It would be difficult for the Commission to determine whether that allocation is reasonable, particularly in cases where the package includes nonregulated services and services removed from price cap regulation pursuant to a grant of pricing flexibility. Therefore, USTA's proposal would not be an adequate safeguard against cross-subsidization.

166. The other possible safeguard that we have considered would require the Commission to specify the cost allocation rules LECs would use to segregate costs and revenues from services in price cap regulation from the costs and revenues of services outside of price cap regulation. Such rules would be burdensome for carriers and the Commission and is inconsistent with the deregulatory framework envisioned by Congress when it adopted the Telecommunications Act of 1996. Indeed, we find that such cost accounting rules would make using the low-end adjustment mechanism just as burdensome as making an above-cap filing. We have retained the low-end adjustment mechanism in part to avoid costly above-cap

[414] *Id.* 67-68.

[415] *Id.* at 67.

[416] Courts also have held that a utility company's captive customers should bear the risk of loss of the utility's investment only if those customers also are permitted to share in the benefits resulting from that investment. *See* Democratic Cent. Comm. of the Dist. of Columbia v. Washington Metro. Area Transit Comm'n, 485 F.2d 786, 805 (D.C.Cir.1973), *cert. denied*, 415 U.S. 935 (1974); AT&T Info. Sys., Inc. v. FCC, 854 F.2d 1442, 1444 (D.C. Cir. 1988).

[417] USTA *ex parte* statement of Jan. 27, 1999, at 3-4.

filings.[418] Burdening the low-end adjustment mechanism with cost allocation rules thus would undercut a major reason for retaining the low-end adjustment mechanism as part of the price cap plan. On the other hand, elimination of the low-end adjustment mechanism for an incumbent LEC might enable the Commission to relax, for that LEC, any accounting rules necessitated only by the rate-of-return-based low-end adjustment mechanism. For all these reasons, we eliminate the low-end adjustment mechanism for price cap LECs obtaining pricing flexibility.

167. Any LEC obtaining Phase I regulatory relief in any MSA will be precluded from making any low-end adjustment throughout its entire, holding-company-wide, service region, regardless of whether it files separate tariffs for each of its study areas. Permitting MSA-by-MSA low-end adjustments would require the same kind of burdensome cost allocation rules that we describe above. Furthermore, eliminating the low-end adjustment will not result in confiscatory rates, because we will continue to permit price cap LECs to make above-cap tariff filings. We also conclude that an above-cap tariff investigation provides the best forum for determining whether the above-cap tariff would implicitly force the LEC's regulated ratepayers to bear some of the risk of the LEC's competitive ventures.[419]

168. We retain the low-end adjustment mechanism for price cap LECs that have not opted to exercise any Phase I or Phase II regulatory relief, however. As we note above, the flexibility we grant in Phase I and Phase II will exacerbate the efficiency-blunting effects of the low-end adjustment mechanism. By the same token, the inefficiencies associated with the low-end adjustment mechanism in the absence of these flexibilities are fairly minor. To be eligible for a low-end adjustment, a price cap LEC must earn less than a 10.25 percent rate of return, which would constitute a substantial earnings sacrifice for most price cap LECs. For those LECs, the benefits of the low-end adjustment mechanism would not justify such a sacrifice, because the mechanism permits only a one-time PCI adjustment to avoid back-to-back annual earnings below 10.25 percent. For this reason, we find that the benefits of retaining the low-end adjustment mechanism for those LECs that have not obtained Phase I or Phase II relief (ensuring that LECs' rates are not confiscatory without requiring above-cap filings) outweigh its effects on efficiency incentives.

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[418] The Commission retained the low-end adjustment mechanism to help prevent price cap regulation from becoming confiscatory. *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16704. The above-cap filing is the only other mechanism in price cap regulation designed explicitly to prevent confiscatory rates. Any above-cap filing must be supported by the following: (1) cost support data broken down to the lowest possible level for each relevant basket for each of the most recent four years under price cap regulation; (2) a detailed explanation of the reasons for the prices of all rate elements to which the LEC does not assign costs; (3) a comprehensive explanation of how the carrier allocated costs among rate elements in the relevant basket; and (4) an explanation of the manner in which the LEC has allocated all costs, not just exogenous costs, among baskets. *LEC Price Cap Order*, 5 FCC Rcd at 6823.

[419] The Commission has stated that it would probably suspend any above-cap filing for the statutory five-month period. *Id.* at 6823-24.

3. Common Line Basket Issues

169. Above, we permit incumbent LECs to offer contract tariffs and volume and term discounts for access services once they satisfy the Phase I triggers. We also have designed our Phase I relief to limit headroom by requiring price cap LECs to remove the demand associated with contract tariff offerings from price caps, so that price cap LECs cannot use that pricing flexibility to raise access rates for those customers in the MSA that lack competitive alternatives. Phase I pricing flexibility for services in the common line basket does not raise the same concerns regarding headroom, because different price cap rules apply to the common line basket. There is no need to require price cap LECs to remove common line services offered pursuant to contract tariff from price caps, nor do we see any need for additional safeguards to prevent the creation of headroom as a result of volume and term discounts for services in the common line basket, because the current rules already preclude the creation of headroom in the common line basket. Specifically, Section 69.152(m) prohibits price cap carriers that choose to charge less than the maximum permitted end user common line charges (EUCLs) from making up any of that revenue through increases to other common line charges (primary interexchange carrier charges (PICCs) or carrier common line CCL) charges).[420] Similarly, Section 69.153 requires incumbent LECs to base their PICC calculations on the maximum revenues permitted under the rules, rather than the actual revenues recovered.[421] Thus, our rules do not permit a LEC to charge a higher PICC for some subscriber lines simply by reducing the PICC for other lines. Finally, Section 69.154 allows price cap LECs to impose CCL charges only to the extent that their permitted common line revenues exceed the maximum amount the LECs could have recovered through EUCLs and PICCs.[422]

E. Procedural Issues

1. Special Access and Dedicated Transport Services

170. *Background.* In the *Access Reform NPRM*, the Commission invited comment on the procedural requirements governing requests for pricing flexibility.[423] The Commission did not propose any specific pleading cycle, but it proposed establishing a deadline for Commission action of 90 days.[424]

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[420] 47 C.F.R. § 69.152(m).

[421] 47 C.F.R. § 69.153.

[422] 47 C.F.R. § 69.154. Other restrictions also apply.

[423] *Access Reform NPRM*, 11 FCC Rcd at 21432, 21444.

[424] *Id.* at 21431.

171. *Discussion.* An incumbent LEC seeking pricing flexibility for special access or dedicated transport services under the framework we adopt in this Order may file a petition with the Commission identifying the relief it seeks and demonstrating that it has satisfied the applicable triggers. Comments on petitions will be due fifteen days after the petition is filed. Replies will be due ten days after the comments are due. The triggers established for special access and dedicated transport services are administratively simple and easy to verify. A relatively short pleading cycle is, therefore, sufficient to enable interested parties to examine the incumbent LEC's petition and to draft a response. We will notify interested parties of a pending pricing flexibility petition through the Competitive Pricing Division's Tariff Public Reference Log. In addition, we require incumbent LECs to submit pricing flexibility petitions through our Electronic Tariff Filing System (ETFS), so that interested parties may obtain copies of petitions through the Commission's website.

172. Incumbent LECs bear the burden of proving that they have satisfied the applicable trigger for the pricing flexibility they seek.[425] An incumbent LEC is in the best position to present evidence of the extent of collocation in its wire centers within an MSA. We also adopt Ameritech's proposal to permit incumbent LECs to file petitions for multiple MSAs, as long as the data in those petitions are disaggregated by MSA.[426] Specifically, to carry its burden of proof, the incumbent may show the following: (1) the total number of wire centers in the MSA; (2) the number and location of the wire centers in which competitors have collocated; (3) in each wire center on which the incumbent bases its petition, the name of at least one collocator that uses transport facilities owned by a provider other than the incumbent to transport traffic from that wire center; and (4) that the percentage of wire centers in which competitors have collocated satisfies the trigger we have adopted with respect to the pricing flexibility sought by the incumbent LEC. Alternatively, the incumbent may show the following: (1) the total base period[427] revenues generated by the services for which the incumbent seeks relief in the MSA for which the incumbent seeks relief; (2) in each wire center on which the incumbent bases its petition, the name of at least one collocator that uses transport facilities owned by a provider other than the incumbent to transport traffic from that wire center; and (3) that the wire centers in which competitors have collocated account for a sufficient percentage of the incumbent's base period revenues generated by the services at issue within the relevant MSA or non-MSA area to satisfy the trigger we have adopted with respect to the pricing flexibility sought by the incumbent LEC. We codify these requirements in a new Section 1.774 of our rules, as set forth in Appendix B to this Order.

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[425] *See* Spectranet Comments at 5-6.

[426] Ameritech Oct. 26 Comments, Att. N at 3, 5.

[427] For price cap LECs, the "base period" is the 12-month period (*i.e.*, the calendar year) ending six months before the effective date of the LECs' annual access tariffs. *See* 47 C.F.R. § 61.3(e).

173. Currently, the Commission's new service rules require price cap LECs to determine the appropriate price cap basket and service band for their new services in the context of a subsequent annual access tariff filing, and to incorporate those new services into those baskets in that annual access filing.[428] Whenever a price cap LEC can demonstrate in an annual access tariff filing that one of its new services would be properly incorporated into a basket or service band for which it has been granted Phase I or Phase II regulatory relief in any MSA or MSAs, it will be granted the same relief in the same MSAs for that new service.

174. We also amend Section 0.291, listing the authority delegated to the Chief, Common Carrier Bureau (Bureau), explicitly to delegate authority to issue Orders acting on petitions for pricing flexibility involving special access and dedicated transport services. Because the pricing flexibility triggers we adopt for those services are administratively simple bright-line tests, Bureau-level review is sufficient to determine whether the incumbent LEC has satisfied the applicable test.

175. Finally, a pricing flexibility petition for special access and dedicated transport services will be deemed granted unless the Bureau denies it within 90 days of the close of the pleading cycle, as the Commission proposed in the *Access Reform NPRM*.[429] Ameritech recommends adopting a deadline of 90 days after the filing date of the petition, rather than 90 days after the close of the pleading cycle.[430] Although we expect our pricing flexibility thresholds to be simple to administer, it is prudent to allow more time to review pricing flexibility petitions, at least until we gain more experience. The Bureau may, of course, issue an Order before this 90-day deadline if it has completed the review. Also, if experience shows that a full 90 days is not necessary to review pricing flexibility petitions, we may consider relaxing this or other procedural requirements. The period for filing applications for review begins the day the Bureau grants or denies the petition, or the day that the petition is deemed denied.

2. Treatment of Proprietary Data

176. In the event that a price cap LEC wishes to request confidential treatment of any information contained in a pricing flexibility petition, it should follow the procedures for obtaining confidential treatment of tariff cost support information. The price cap LEC must demonstrate, by a preponderance of the evidence, that the information should be withheld from public inspection in accordance with the requirements of Section 0.459 of the

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[428] Specifically, price cap LECs are required to incorporate new services into a price cap basket in the annual access tariff filing effective between 6 and 18 months after the new service tariff takes effect. 47 C.F.R. § 61.42(g).

[429] *Access Reform NPRM*, 11 FCC Rcd at 21431.

[430] Ameritech Comments, Attachment N at 3, 5.

Commission's rules.[431] A price cap LEC wishing to request confidential treatment of information contained in a pricing flexibility petition should demonstrate, by a preponderance of the evidence, that the information should be withheld from public inspection in accordance with the requirements of Section 0.459 of this chapter.

177. In their requests for confidentiality, carriers should indicate with specificity the extent to which they believe the information they submit, such as the identity of collocators, is subject to section 222(b) of the Act concerning confidential carrier information,[432] and the bases for that belief. The information will be kept confidential, as appropriate, subject to Commission procedures concerning Freedom of Information Act (FOIA) requests. Although the Commission will consider any FOIA requests on a case-by-case basis, pursuant to applicable law, we note that FOIA exceptions, such as the exception for "trade secrets and commercial or financial information,"[433] may prevent disclosure of such information. A price cap LEC will be required, in any event: (1) to provide collocation information to parties to the extent that the parties are the collocators upon which the price cap LEC relies in its petition, (2) to certify in its petition that it has done so, and (3) to provide to the Commission a copy of the information it provides to those parties. In such cases, the LEC may provide the data to a party in redacted form, revealing to the party only the information relating to that party.

3. Other Switched Access Services

178. We will grant Phase I pricing flexibility for common line and traffic-sensitive services, and the traffic-sensitive components of tandem-switched transport service to a price cap LEC within an MSA if the LEC demonstrates that its competitors, in aggregate, offer service over their own facilities to at least 15 percent of incumbent LEC customer locations in the MSA. For the reasons we explain in Section VI.C.3, we do not prescribe a particular method by which a LEC may demonstrate satisfaction of this trigger. As a result, petitions seeking pricing flexibility for these services will not be as routine as petitions seeking pricing flexibility for special access and dedicated transport services. Because pricing flexibility petitions for common line, traffic-sensitive, and the traffic-sensitive components of tandem-switched transport services are not subject to a bright-line rule, and will require more fact-intensive investigation, they are best addressed at the Commission level. Accordingly, we do not delegate authority to the Bureau at this time to act on petitions for pricing flexibility involving these services. A pricing flexibility petition for these services will be deemed

[431] *See* 47 C.F.R. §§ 0.459. *See also* Examination of Current Policy Concerning the Treatment of Confidential Information Submitted to the Commission, CC Docket No. 96-55, Report and Order, 13 FCC Rcd 24816, 24840-42 (1998) (*Treatment of Confidential Information Order*); *Tariff Streamlining Order*, 12 FCC Rcd at 2212-14.

[432] *See* 47 U.S.C. § 222(b).

[433] *See* 5 U.S.C. § 552(b)(4).

granted unless the Commission denies it within five months of the close of the pleading cycle for that petition. Otherwise, we adopt the same procedural requirements for pricing flexibility petitions for these services as we adopt above for pricing flexibility petitions for special access and dedicated transport services. As the Commission gains experience with such petitions, it may be possible for the Commission to act in less than the full five months, or to delegate authority to the Bureau with respect to these petitions.

F. U S West Forbearance Petition

179. As we note above, several BOCs have filed petitions seeking forbearance, pursuant to section 160 of the Act,[434] from dominant carrier regulation in the provision of certain special access and high capacity services.[435] The first of these petitions, filed by U S West, is deemed granted if not denied by the Commission by August 24, 1999, unless the Commission extends the deadline for an additional ninety days.[436] We conclude that such an extension is warranted here. In this Order, we adopt a comprehensive framework for granting price cap LECs such as U S West progressively greater pricing flexibility as competition develops, including much of the relief sought by U S West in its petition, and an extension of the deadline for acting on that petition will allow the Commission to consider U S West's request for relief in the context of the rules we adopt here. Accordingly, we extend the deadline for acting on U S West's petition by ninety days.

VII. CLEC ACCESS CHARGES

A. Background

180. In the *Competitive Carrier Proceeding*, the Commission established a comprehensive framework for determining whether carriers are dominant or non-dominant.[437] Dominant carriers[438] are carriers that possess individual market power and those without

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[434] 47 U.S.C. § 160.

[435] *See supra* Section II.C.1.

[436] *See* Petition of U S West Communications, Inc. for Forbearance from Regulation as a Dominant Carrier in the Phoenix, Arizona MSA, CC Docket No. 98-157 (filed Aug. 24, 1998); 47 U.S.C. § 160(c) (imposing one-year deadline for Commission action on forbearance petition; Commission may extend the deadline by 90 days if necessary to ensure compliance with the statutory forbearance criteria).

[437] *Dominant/Non-Dominant Order*, 12 FCC Rcd 15766.

[438] *Competitive Carrier First Report and Order*, 85 FCC 2d at 20-22; see also 47 C.F.R. § 61.3(o) (defining "dominant carrier").

market power are non-dominant carriers.[439] The Commission's policy since *Competitive Carrier* is that a carrier is non-dominant unless the Commission makes or has made a finding that it is dominant.[440] New entrants into the exchange access market, such as competitive local exchange carriers (CLECs),[441] have been presumptively classified as non-dominant because the Commission has not found that they are able to exercise market power in particular service areas.[442] To date, the Commission has applied Parts 61 (Tariffs) and 69 (Access Charges) of its rules only to incumbent LECs.[443]

181. In the *Access Reform NPRM*, the Commission sought comment on whether CLECs have market power with regard to terminating access services and whether and to what extent it should regulate terminating access services provided by CLECs.[444] The Commission noted that, with originating access, the calling party has the choice of service provider, the decision to place a call, and the ultimate obligation to pay for the call.[445] The calling party is also the customer of the IXC that purchases the originating access service.[446] As long as IXCs can influence the choice of the access provider, a LEC's ability to charge

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[439] The Commission, in the *Dominant/Non-Dominant Order*, listed a number of factors that historically have been considered in determining whether a firm possesses market power, including market share, supply and demand substitutability, the cost structure, size, and resources of the firm, and control of bottleneck facilities. *See Dominant/Non-Dominant Order*, 12 FCC Rcd at 15766. *See also* Implementation of Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934 and Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area, CC Docket No. 94-149, Notice of Proposed Rulemaking, 11 FCC Rcd 18877, at 18929-38 (1996).

[440] *See, e.g., Competitive Carrier First Report and Order*, 85 FCC 2d at 10-11; 47 C.F.R. § 61.3(u) (defining "non-dominant carrier").

[441] CLECs compete with incumbent LECs in the provision of local exchange and exchange access services.

[442] See Tariff Filing Requirements for Non-Dominant Common Carriers, CC Docket No. 93-36, Memorandum Opinion and Order, 8 FCC Rcd 6752, 6754 (1993) (CLECs are non-dominant carriers because they have not been previously declared dominant), *vacated and remanded in part on other grounds*, Southwestern Bell Corp. v. FCC, 43 F.3d 1515 (D.C. Cir. 1995); *on remand*, 10 FCC Rcd 13653 (1995).

[443] *See* Hyperion Telecommunications, Inc., Petition for Forbearance, Memorandum Opinion and Order, 12 FCC Rcd 8596 (1997) (granting petitions seeking permissive detariffing for provision of interstate exchange access services by providers other than the incumbent LEC) (*Hyperion Order*). Concomitantly with the *Hyperion Order*, the Commission issued a Notice of Proposed Rulemaking seeking comment on mandatory detariffing for non-incumbent LEC providers of interstate exchange access services. *See* Complete Detariffing for Competitive Access Providers and Competitive Local Exchange Carriers, CC Docket No. 97-146, Notice of Proposed Rulemaking, 12 FCC Rcd 8613 (1997).

[444] *Access Reform NPRM*, 11 FCC Rcd at 21476.

[445] *Id.* at 21472.

[446] *Id.*

excessive originating access rates is limited, as IXCs will shift their traffic from that carrier to a competing access provider.[447] The Commission noted that, with terminating access, the choice of service provider for terminating access is made by the called party.[448] The decision to place the call and payment for the call lies, however, with the calling party. The calling party, or its long-distance service provider, has little or no ability to influence the called party's choice of service provider.[449] Furthermore, IXCs are required by statute to charge averaged rates.[450] Consequently, not only does the calling party not choose the terminating LEC, but section 254(g) requires IXCs to spread the cost of terminating access rates among all end users. Because the paying party does not choose the carrier that terminates its interstate calls, CLECs may have incentive to charge excessive rates for terminating access.[451] Accordingly, the Commission tentatively concluded in the *Access Reform NPRM* that terminating access may remain a bottleneck controlled by whichever LEC provides terminating access to a particular customer, even if competitors have entered the market.[452] The Commission also recognized, however, that excessive terminating access charges might encourage IXCs to enter the access market in order to avoid paying these charges.[453]

182. In the *Access Reform NPRM*, the Commission also sought comment on whether it should continue to treat incumbent LEC originating "open end" minutes, such as originating access for 800 service, as terminating minutes for access charge purposes, and whether it should extend this approach to CLECs.[454] The Commission noted that, in some cases, such as

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[447] *Id.*

[448] *Id.* at 21476.

[449] *Id.*

[450] *See* 47 U.S.C. § 254(g); *see also* Policy and Rules Concerning the Interstate, Interexchange Marketplace, Implementation of Section 254(g) of the Communications Act of 1934, as amended, CC Docket No. 96-61, Report and Order, 11 FCC Rcd 9564 (1996) (requiring IXCs to integrate and average the rates they charge for service).

[451] *Access Reform NPRM*, 11 FCC Rcd at 21476 (citing JOSEPH GILLAN & PETER ROHRBACH, THE POTENTIAL IMPACT OF LOCAL COMPETITION ON TELECOMMUNICATIONS MARKET STRUCTURE: DIVERSITY OR RECONCENTRATION, 1994; ROBERT W. CRANDALL AND LEONARD WAVERMAN, TALK IS CHEAP: THE PROMISE OF REGULATORY REFORM IN NORTH AMERICAN TELECOMMUNICATIONS, 1996, at 265-265).

[452] *Access Reform NPRM*, 11 FCC Rcd at 21476.

[453] *Id.* at 21473.

[454] *See id.* at 21477. "The term open end of a call describes the origination or termination of a call that utilizes exchange carrier common line plant (a call can have no, one, or two open ends.") 47 C.F.R. § 69.105(b)(1)(ii).

800 and 888 service, the called party, which pays for the call, is unable to influence the calling party's choice of provider for originating access services.[455]

183. In the *Access Reform First Report and Order*, the Commission decided not to adopt any regulations governing CLEC terminating access charges and did not address the issue of CLEC originating access charges.[456] Based on the available record, the Commission decided to continue to treat non-incumbent LECs as non-dominant in the provision of terminating access service.[457] Although an IXC must use the CLEC serving an end user to terminate a call, the Commission found that the record did not indicate that CLECs previously had charged excessive terminating access rates or that CLECs distinguished between originating and terminating access in their service offerings.[458] The Commission concluded that it did not appear that CLECs had structured their service offerings in ways designed to exercise any market power over terminating access and that, therefore, the concerns expressed in the *Access Reform NPRM* were not substantiated by the record.

184. The Commission further observed that, as CLECs attempt to expand their market presence, the rates of incumbent LECs or other potential competitors should constrain the CLECs' terminating access rates.[459] In addition, the Commission found that overcharges for terminating access could encourage access customers to take competitive steps to avoid paying unreasonable terminating access charges.[460] The Commission explained that, although high terminating access charges may not create a *disincentive* for the call recipient to retain its local carrier (because the call recipient does not pay the long distance charge), the call recipient may nevertheless respond to *incentives* offered by an IXC with an economic interest in encouraging the end user to switch to another local carrier.[461] Thus, the Commission

[455] *See Access Reform NPRM*, 11 FCC Rcd at 21477.

[456] With respect to incumbent LEC originating access charges, the Commission concluded that new entrants, by purchasing unbundled network elements or providing facilities-based competition, eventually will exert downward pressure on incumbent LEC originating access rates. *Access Reform First Report and Order*, 12 FCC Rcd at 16135-36.

[457] *Access Reform First Report and Order*, 12 FCC Rcd at 16140.

[458] *Id.* The Commission noted, in fact, that the record indicated that the terminating rates of CLECs were equal to or below the tariffed rates of incumbent LECs. *Id.*

[459] The Commission stated that the record indicated that long-distance carriers have established relationships with incumbent LECs for the provision of access services, and new market entrants are not likely to risk damaging their developing relationships with IXCs by charging unreasonable terminating access rates. *Id.*

[460] *Id.*

[461] *Id.* at 16141.

concluded that the possibility of competitive responses by IXCs would constrain non-incumbent LEC pricing.[462]

185. Although the Commission declined at that time to adopt any regulations governing the provision of terminating access provided by CLECs because CLECs did not appear to possess market power,[463] it noted that it could address the reasonableness of CLEC terminating access rates in individual instances through the exercise of its authority to investigate and adjudicate complaints under section 208.[464] Moreover, the Commission stated that it would be sensitive to indications that the terminating access rates of CLECs were unreasonable.[465] The Commission committed to revisit the issue of CLEC access rates if there were sufficient indications that CLECs were imposing unreasonable terminating access charges.[466]

B. AT&T's Petition for Declaratory Ruling

186. On October 23, 1998, AT&T filed a petition requesting that the Commission issue a declaratory ruling[467] confirming that, under existing law and Commission rules and policies, IXCs may elect not to purchase switched access services offered under tariff by CLECs.[468] AT&T contends that a substantial number of CLECs impose switched access charges that are significantly higher -- in some cases, by more than twenty times -- than those

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[462] *Id.* at 16142. The Commission also decided to continue to treat "open end" originating minutes, such as those for 800 or 888 services, as terminating minutes for access charge purposes, recognizing, in these cases, that access customers have limited ability to influence the calling party's choice of access provider. *Id.* In order to address the potential that incumbent LECs might charge unreasonable rates for terminating access, the Commission limited price cap incumbent LEC recovery of TIC and common costs from terminating access rates for a limited period with the eventual elimination of any recovery of common line and TIC costs through terminating access charges. *Id.* at 16137.

[463] *Id.* at 16141.

[464] 47 U.S.C. § 208.

[465] *Access Reform First Report and Order*, 12 FCC Rcd at 16141-42. The Commission indicated that terminating access rates that exceed originating rates in the same market, for example, may suggest the need to revisit its regulatory approach. Similarly, the Commission noted that terminating rates that exceed those charged by the incumbent LEC serving the same market may suggest that a CLEC's terminating access rates are excessive. *Id.* at 16142.

[466] *Id.*

[467] *See* 47 C.F.R. § 1.2.

[468] *See AT&T Declaratory Ruling Petition.* We note that, unless otherwise indicated, all citations to comments and replies in this section of the Order refer to comments and replies submitted in response to the *AT&T Declaratory Ruling Petition.*

charged by the incumbent LEC against which the CLEC competes.[469] AT&T's attempts to negotiate a resolution of this issue have stalled, it says, because many CLECs take the position that, due to the "filed tariff doctrine,"[470] AT&T is obligated to accept services from the CLEC at prices chosen by the CLEC, even though AT&T did not affirmatively order access from the CLEC.[471] AT&T alleges that its petition is consistent with the *Access Reform First Report and Order*, in which the Commission stated that "terminating rates that exceed those charged by the ILEC serving the same market may suggest that a CLEC's terminating access rates are excessive."[472]

187. The Commission has the discretion, on a case-by-case basis, to determine whether it is best to resolve a controversy by the adoption of a general rule or by an individual ad hoc proceeding, such as a declaratory ruling.[473] The presence or absence of factual disputes is a significant factor in deciding whether a declaratory ruling is an appropriate method for resolving a controversy.[474] AT&T contends that a declaratory ruling is

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[469] *AT&T Declaratory Ruling Petition*, Appendix A. We note that this issue is also the subject of the Common Carrier Bureau's (Bureau) decision in MGC Communications, Inc. v. AT&T Corp., File No. EAD 99-002, Memorandum Opinion and Order, DA 99-1395 (Com. Car. Bur. July 16, 1999) (*MGC Communications*).

[470] In general, the "filed tariff" or "filed rate" doctrine stands for the principle that "the rate of the carrier duly filed is the only lawful charge. Deviation from it is not permitted upon any pretext . . . . Ignorance or misquotation of rates is not an excuse for paying or charging either less or more than the rate filed." Maislin Industries, U.S., Inc. v. Primary Steel, Inc., 497 U.S. 116, 127 (1990) (quoting Louisville & Nashville R. Co. v. Maxwell, 237 U.S. 94 (1915)). The filed tariff doctrine is codified at 47 U.S.C. § 203, which requires all common carriers of interstate and foreign telecommunications to file a schedule of their charges, as well as the classifications, practices, and regulations affecting such charges. A carrier may charge only the rates listed in the tariff. 47 U.S.C. § 203(c)(1). The charges, classifications, regulations or practices in the filed tariff may be changed only after notice is given to the Commission and the public. 47 C.F.R. § 203(b)(1). See also Cincinnati Bell Telephone v. Allent Communication Services, 17 F.3d 921, n.4 (6th Cir. 1994).

[471] *AT&T Declaratory Ruling Petition* at 3, n.2. AT&T does not typically place access orders, or establish direct connections, with such CLECs. Id. Instead, the CLEC establishes an interconnection arrangement with the incumbent LEC serving the area, and it installs trunks to the incumbent LEC's access tandem. *Id.* Calls originated from the CLEC's switch are routed to the incumbent LEC tandem, which then combines them with other traffic destined for AT&T or another IXC's network and routes that traffic to that IXC's POP. *Id.* Terminating traffic from AT&T and other IXCs similarly is routed through the incumbent LEC access tandem to the CLEC. *Id.*

[472] *Id.* at 9 (citing *Access Reform First Report and Order*, 12 FCC Rcd at 16135-42).

[473] *See, e.g.*, British Caledonian Airways Ltd. v. Civil Aeronautics Board, 584 F.2d 982, 993 (1978) (the choice made between proceeding by a general rule or by an individual ad hoc litigation is one that lies primarily in the informed discretion of the administrative agency) (*British Caledonian Airways Ltd.*).

[474] American Network, Inc. Petition for Declaratory Ruling Concerning Backbilling of Access Charges, Memorandum Opinion and Order, 4 FCC Rcd 550, 551 (Com. Car. Bur. 1989), *recon. denied*, 4 FCC Rcd 8797 (Com. Car. Bur. 1989). We note that the factors for determining the propriety of a declaratory ruling are

appropriate here because the "facts are essentially undisputed and the governing law is clear."[475] Despite AT&T's allegations to the contrary, however, the facts are not undisputed here. A number of carriers assert that AT&T's calculations of CLEC originating and terminating access rates[476] are either incorrect or misleading.[477] In response to these assertions, AT&T addressed only one of the concerns raised by commenters.[478] Without agreement by the parties on the calculation and accuracy of both the incumbent LEC and CLEC rates, it is impossible compare them.[479] Nor can the Commission evaluate AT&T's claim that its request for declaratory ruling is consistent with the Commission's statements in the *Access Reform First Report and Order* that CLEC terminating access rates that exceed those of the incumbent LEC may be excessive.[480]

188. Moreover, the parties also dispute the applicable law. A number of opponents to AT&T's petition assert that AT&T mistakenly relies upon the *Capital Network* decision, in

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different in the context of a court referral under the primary jurisdiction doctrine. *See* Texas & Pacific Ry. v. Abilene Cotton Oil Co., 204 U.S. 426 (1907) (creating "primary jurisdiction" doctrine); United States v. Western Pacific R.R., 352 U.S. 59, 63-70 (1956) (explaining purpose of the doctrine); Far East Conference v. United States, 342 U.S. 570, 574 (1952) (same); MCI Communications Corp. v. AT&T, 496 F.2d 214, 220-22 (3d Cir. 1974) (applying the doctrine in the telecommunications context)).

[475] *AT&T Declaratory Ruling Petition* at 5.

[476] *See id.* at Appendix A.

[477] *See* WinStar Comments at 6; Optel Comments at 5; CTSI Comments at 10 (rates attributed to WinStar, Optel, and CTSI, respectively, are incorrect); ALLTEL Comments at 2 and ALTS Comments at 6 (AT&T's rate comparison is misleading because it does not reflect the fact that price cap carriers rates are reduced as a result of the introduction of presubscribed interexchange carrier charge); Teligent, Inc. Comments at 9 (AT&T fails to include an amount for transport in the rates charged by Ameritech, the local incumbent LEC, but does include an amount for transport in Teligent's rates).

[478] AT&T states that inclusion of the presubscribed interexchange carrier charge (PICC) would not make a material difference to its calculation, but it does not address the carriers' other concerns regarding AT&T's calculations, i.e., that rates were misquoted and did not include incumbent LEC transport charges. *See* AT&T Reply at 4, n.10, and Appendix B, providing a recomputed comparison including the PICC.

[479] In its reply, AT&T argues that its petition is not a dispute over rate calculations because it is not limited to CLECs that charge rates exceeding the corresponding ILEC levels, but also applies to CLECs that charge rates that simply mirror incumbent LEC rates. AT&T Reply at 4. AT&T asserts that both rates that exceed and rates that mirror incumbent LEC rates distort the exchange access market by establishing the incumbent LECs' purportedly above-cost charges as a benchmark for CLECs. We do not find this argument convincing. At the heart of either complaint is the fact that AT&T views itself as a captive customer forced to pay excessively high terminating rates. In order to evaluate such a complaint, all parties must agree on the method of calculating the disputed rate, *e.g.*, whether transport fees and PICCs are included. Based on the record, it appears that the parties do not.

[480] *AT&T Declaratory Ruling Petition* at 9 (citing *Access Reform First Report and Order*, 12 FCC Rcd at 1635-42).

which the Commission found that an attempt to charge a party for a service that the party did not order would constitute an unreasonable practice within the meaning of section 201(b) of the Act, 47 U.S.C. § 201(b).[481] These opponents assert that AT&T failed to address the application of the constructive ordering doctrine, established in *United Artists*.[482] In *United Artists*, the Commission found that affirmative consent was unnecessary to create a carrier-customer relationship when a carrier is interconnected with other carriers in such a manner that it can expect to receive access services, and when it fails to take reasonable steps to prevent the receipt of access services and does in fact receive such services.[483] For all the foregoing reasons, and in the exercise of our discretion, we decline to address AT&T's concerns regarding CLEC access charges through a declaratory ruling.[484] We therefore deny AT&T's petition.

189. In the *Access Reform First Report and Order*, however, the Commission committed to review the issue of CLEC access charges if there were evidence that CLECs were imposing unreasonable terminating access charges.[485] The *AT&T Petition for Declaratory Ruling*, the comments provided in support of it,[486] and the Bureau's recent decision in *MGC Communications*[487] suggest the need to revisit the issue of CLEC access

[481] *AT&T Declaratory Ruling Petition* at 6-8 (citing Capital Network Systems, Inc., 6 FCC Rcd 5609 (Com. Car. Bur. 1992), *application for review denied*, 7 FCC Rcd 80921 (1992), *aff'd*, Capital Network Systems, Inc. v. FCC, 28 F.3d 201 (D.C. Cir. 1994) (*Capital Network*)).

[482] *See* TRA Comments at 5; MGC Communications Comments at 13; MCI Comments at 4; Cablevision Lightpath, Inc. and Nextlink, Inc. Comments at 3. *See also* United Artists Payphone Corp. v. New York Tel. Co., 8 FCC Rcd 5562 (1993) (*United Artists*).

[483] *United Artists*, 8 FCC Rcd at 5565-66. *See also Capital Network*, 28 F.3d. at 204 (taking notice of the principle of constructive ordering, but finding that the principle does not apply to the billing of incomplete calls).

[484] *See* SBC Comments at 6-7 (requesting that the Commission issue a notice of proposed rulemaking for further comment before deciding the matter because the decision may affect other parties and practices). We note that several parties have raised a number of other substantive objections to AT&T's petition that we need not consider because we are denying the petition on procedural grounds. *See, e.g.*, BellSouth Comments at 3; Total Telecommunication Services Comments at 4-10; MGC Communications Comments at 5; CTSI Comments at 2 (AT&T's petition violates the interconnection policies of Telecommunications Act of 1996).

[485] *Access Reform First Report and Order*, 12 FCC Rcd at 16141-42.

[486] *See AT&T Declaratory Ruling Petition*; Cable & Wireless Comments at 1; U S West Comments at 1; Sprint Comments at 1.

[487] *MGC Communications*, File No. EAD 99-002, Memorandum Opinion and Order, DA 99-1395.

rates.[488] Accordingly, in the accompanying Notice, we initiate a rulemaking to examine CLEC originating and terminating access rates.[489]

VIII. NOTICE OF PROPOSED RULEMAKING

A. Geographic Deaveraging for Switched Access Services

190. In this section, we seek comment on whether to amend our Part 69 rules to permit price cap incumbent LECs to deaverage interstate common line and traffic-sensitive access charges within study areas without a competitive showing. Currently, Section 69.3(e)(7) of our rules requires an incumbent LEC to charges rates for access elements that are averaged across each of its study areas.[490]

191. *Common Line Basket.* In the *Access Reform NPRM*, the Commission requested comment on deaveraging all interstate access rate elements except for the subscriber line charge (SLC) (and the primary interexchange carrier charge (PICC), which did not exist at the time).[491] At that time, however, the Commission proposed to permit deaveraging only upon a showing of the degree to which local markets are open to competition.[492] We now seek comment on whether to permit incumbent LECs to deaverage common line access elements without a competitive showing. To the extent that parties advocate conditioning deaveraging

[488] Although we are initiating a rulemaking into the issue of CLEC access charges, we take no position on the reasonableness of these charges at this time. We merely wish to reexamine the issue in light of the arguments filed both in support of and in opposition to the *AT&T Declaratory Ruling Petition*. For example, the comments opposing AT&T's Petition argue that CLECs may have justifiably higher access charges due to their limited geographical scope and scale and their different cost structures.

[489] *See, e.g., British Caledonian Airways Ltd.*, 584 F.2d at 993.

[490] 47 C.F.R. § 69.3(e)(7). A study area is a geographical segment of a carrier's telephone operations. Generally, a study area corresponds to a carrier's entire service territory within a state. Thus, carriers operating in more than one state typically have one study area for each state, and carriers operating in a single state typically have a single study area. Carriers perform jurisdictional separations at the study area level. For jurisdictional separations purposes, the Commission adopted a rule freezing study area boundaries effective November 15, 1984. Part 36 of the Commission's Rules, 47 C.F.R., Part 36, Appendix-Glossary, definition of "Study Area." *See* MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984), adopted by the Commission, 50 Fed. Reg. 939 (Jan. 8, 1985). Section 69.123 permits incumbents to deaverage rates for services in the trunking basket except for the transport interconnection charge (TIC). In Section V, *supra*, we grant incumbent LECs greater flexibility to deaverage rates for these services.

[491] *Access Reform NPRM*, 11 FCC Rcd at 21433.

[492] For further discussion and analysis of this proposal, *see* Section VI.C.1, *supra*.

upon satisfaction of a competitive showing, we seek comment on the appropriate showing and the procedure by which evidence should be presented and evaluated.[493]

192. We also seek comment on whether to condition an incumbent LEC's authority to deaverage common line access elements on certain regulatory developments, such as deaveraging of unbundled network elements in accordance with our rules,[494] or establishment of explicit universal service high cost support mechanisms, and, if so, how. Should we impose these conditions in addition to any competitive showing that we may require? We note that, where unbundled network elements are deaveraged, continuing to require incumbents to charge access rates that are averaged across the study area may foreclose the incumbent LEC from meeting competition from unbundled network elements in low-cost areas. Similarly, an incumbent LEC's averaged rates will be below that LEC's cost in high-cost areas, thus discouraging competitive entry in those areas. We also seek comment on whether incumbent LECs should be required, as opposed to merely permitted, to deaverage certain or all common line access rate elements based on any conditions, such as the deaveraging of unbundled network element rates in a state.

193. Currently, incumbent LECs recover interstate common line costs through the SLC, PICC, and carrier common line charge (CCLC). The SLC and PICC are flat-rated charges that vary by class of customer, *e.g.*, multi-line business, single-line business, primary residential line, and additional residential lines, subject to various caps.[495] The CCLC is a per-minute charge that does not vary by class of customer.[496] The SLC is assessed directly on end users while the PICC and CCLC are assessed on IXCs. Incumbent LECs are required to recover their interstate-allocated common line costs first through SLCs (subject to caps), then from PICCs (again, subject to caps), and finally from the CCLC. As the SLC and PICC caps rise,[497] the CCLC gradually decreases and will someday be eliminated.

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[493] We note that, if we permit incumbent LECs to deaverage common line and/or traffic-sensitive charges, IXCs may face significantly differing access costs within LEC study areas. This may increase pressure on IXCs to deaverage interstate interexchange service rates in a manner that conflicts with section 254(g) of the Act, which requires IXCs to charge subscribers in rural and high cost areas rates no higher than rates charged to subscribers in urban areas and to charge subscribers in each state rates no higher than rates charged in any other state. 47 U.S.C. § 254(g). *See also* MCI Oct. 26 Comments at 32.

[494] *See* 47 C.F.R. § 51.507(f) (requiring states to deaverage UNEs across at least three geographic zones); ALTS Oct. 26 Comments at 9. We recently issued a *sua sponte* stay of Section 51.507(f) that will remain in effect until six months after the Commission issues its order in CC Docket No. 96-45, finalizing and ordering implementation of high-cost universal service support for non-rural local exchange carriers under section 254 of the Act. *See* Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, CC Docket No. 96-98, FCC No. 99-86, Stay Order (rel. May 7, 1999).

[495] 47 C.F.R. §§ 69.152, 69.153.

[496] 47 C.F.R. § 69.154.

[497] *See* 47 C.F.R. §§ 69.152(k), 69.153.

194. Parties supporting the deaveraging of interstate common line access charges should comment on the appropriate means of distributing deaveraged cost recovery among such charges. We request comment on whether any deaveraging of the SLC and PICC should be subject to current caps on those charges. At present, our rules provide that, to the extent the SLC caps on all lines and the PICC ceilings on primary residential and single-line business (SLB) lines prevent recovery of the full common line revenues permitted by our price cap rules, incumbent LECs may recover the shortfall through non-primary residential (NPR) and multi-line business (MLB) PICCs.[498] Thus, if primary residential and SLB SLCs and PICCs have reached their caps, NPR and MLB PICCs may be funding at least part of this shortfall, *i.e.*, subsidizing residential and SLB PICCs. This subsidy will decrease over time as the caps on the primary-residential and single-line business SLCs rise. To what degree should we condition deaveraging of common line rate elements on developments such as the elimination of the MLB PICC? What constraints, if any, should we place on the means by which certain foregone revenue may be recovered? For example, should we permit deaveraging only within a customer class and for a particular type of charge, *e.g.*, prohibit incumbent LECs from recovering foregone SLC revenue through the CCLC or prohibit incumbent LECs from raising the NPR SLC to fund lower MLB SLCs?

195. Further, we seek comment on the means of recognizing any geographic variation in common line costs, *i.e.*, methods of defining geographic pricing zones. Many states have defined at least three geographic zones for the pricing of unbundled loops pursuant to section 252(d)(1) of the Act.[499] Universal service reform also may require defining zones to reflect different cost characteristics.[500] We seek comment on whether geographic pricing zones for common line charges should be based on UNE or universal service zones or, perhaps, trunking basket service zones.[501] Parties are invited to suggest additional bases for

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[498] 47 C.F.R. § 69.153(d).

[499] *See, e.g.*, Consolidated Petition of AT&T Communications, Inc., and MCI Telecomms. Corp. and Affiliates for Arbitration with Southwestern Bell Tel. Co., Case Nos. TO-97-40 and TO-97-67, at 35-36 (Mo. P.S.C. Dec. 11, 1996); Petition of AT&T Communications, Inc. for Arbitration with GTE Hawaiian Tel. Co., Docket No. 96-0329, Decision No. 15528 at 36 (Haw. P.U.C. Apr. 18, 1997). Section 51.507(f) requires states to create at least three geographic rate zones for unbundled network elements. 47 C.F.R. § 51.507(f). We note that despite the fact that Section 51.507(f) of our rules was ineffective when most states determined whether to deaverage geographically unbundled network element rates, many states, such as those listed here, chose to do so.

[500] Federal-State Joint Board on Universal Service, CC Docket 96-45, Forward-Looking Mechanism for High Cost Support for Non-Rural LECs, CC Docket No. 97-160, Access Charge Reform, CC Docket No. 96-262, Seventh Report and Order and Thirteenth Order on Reconsideration in CC Docket No. 96-45 and Fourth Report & Order in CC Docket No. 96-262, 14 FCC Rcd 8078, 8126-30 (1999) (*Universal Service Seventh Report and Order*).

[501] *See, e.g., id.* We relax our rules concerning zone pricing of trunking basket services in Section V, *supra*.

establishing geographic zones. For example, should we require LECs to establish identical geographic pricing zones for all access elements?

196. We seek comment on whether to permit incumbent LECs to define their own zones. If so, should we place any constraints on incumbent LEC zone pricing plans for common line service? For example, must an incumbent LEC demonstrate that such zones are based on cost? If so, how? Should there be a limit on the number or size of such zones? We note, for example, that in the accompanying Order we grant incumbent LECs greater flexibility to deaverage rates for services in the trunking basket, but we require each zone, except the highest-cost zone, to account for at least 15 percent of the incumbent's trunking basket revenues in the study area.[502]

197. In addition, we seek comment on the procedures by which the Commission might permit incumbent LECs to define common line access charge zones. Should we require parties to submit for prior approval such zone pricing plans in advance of tariff filings, as we initially required for special access and switched transport zone pricing plans?[503] If so, what information should we require parties to submit?

198. We also seek comment on whether the use of different zones for unbundled network elements, universal service, and access charges would create inefficiencies and arbitrage opportunities.[504] We seek comment on alternative approaches for ensuring that the zones for these different purposes are compatible and that geographic zones generally reflect cost differences.[505]

199. *Traffic-sensitive basket.* The traffic-sensitive basket includes local switching, information, data base access services, billing name and address, local switching trunk ports, and signaling transfer point port termination.[506] In the past, parties have argued that traffic-sensitive service costs vary little, if at all, within study areas.[507] Furthermore, we are unaware of any state commission that has deaveraged an incumbent LEC's rates for unbundled local switching. We invite parties to submit further evidence regarding the degree to which costs of traffic-sensitive services may vary geographically within incumbent LEC

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[502] *See* Section V, *supra*. We adopt that requirement to ensure that incumbent LECs cannot define zones that are, for all practical purposes, specific to particular customers.

[503] *See, e.g., Special Access Expanded Interconnection Order*, 7 FCC Rcd at 7456-57.

[504] *See Universal Service Seventh Report and Order*, 14 FCC Rcd at 8128-29.

[505] For example, different geographic zones may work for these purposes so long as the results are not widely disparate in any particular location.

[506] 47 C.F.R. § 61.42(e)(2).

[507] *See, e.g.*, MCI Nov. 5 Reply Comments at 31-32, 36-37; Time Warner Oct. 26 Comments at 14.

study areas and whether any such variance warrants permitting incumbent LECs to deaverage traffic-sensitive charges. We seek comment on whether we should establish similar or identical rules concerning any deaveraging of traffic-sensitive elements as we may establish for common line elements. For example, should we establish similar or identical rules regarding the methods and procedures for establishing rate zones for traffic-sensitive services, to the extent that they should differ from common line or transport zones? In Section VIII.C, *infra*, we seek comment on replacing the existing per-minute or per-call local switching rate structure rules with a capacity-based rate structure. How might deaveraging of traffic-sensitive charges be affected by such changes in the switching rate structure?

B. Phase II Pricing Flexibility for Switched Service

200. In this section, we seek comment on Phase II pricing flexibility for common line and traffic-sensitive services, and the traffic-sensitive components of tandem-switched transport services offered by price cap incumbent LECs.[508] We seek comment on the appropriate triggers for such relief and how Phase II relief for common line and traffic-sensitive services might differ from Phase II relief for dedicated transport and special access services that we establish in the Order accompanying this Notice.[509]

1. Triggers

201. As we discuss in the Order, Phase II relief is warranted when an incumbent LEC demonstrates that competitors have established a significant market presence, *i.e.*, that competition for a particular service within a geographic area is sufficient to preclude the incumbent from exploiting any monopoly power over a sustained period.[510] In the Order, we conclude that an incumbent price cap LEC is entitled to Phase I pricing flexibility for common line and traffic-sensitive services in an MSA when it demonstrates that competitors, in aggregate, offer service over their own facilities to at least 15 percent of incumbent LEC customer locations in the MSA.[511] We seek comment on whether we should predicate Phase II relief for these services on a similar showing that competitors offer these services over their own facilities but adopt a threshold higher than 15 percent, and, if so, what this threshold

[508] As in our discussion of Phase I triggers for common line service, traffic-sensitive service, and traffic-sensitive components of tandem-switched transport service in Section VI.C.3, *supra*, references to "traffic-sensitive service" in this section include the traffic-sensitive components of tandem-switched transport service. The elements of tandem-switched transport are discussed in Section VI.C.3, *supra*. *See also* 47 C.F.R. § 69.111. We address Phase II pricing flexibility for the dedicated portion of tandem switched transport in Section VI.C.2, *supra*.

[509] *See* Section VI.C.5.c, *supra*.

[510] *See* Section VI.C.5, *supra*.

[511] *See* Section VI.C.3, *supra*.

should be. If a different approach is warranted for Phase II relief, what should the relevant test(s) be?

202. In the Order, we decline to include customer locations served by mobile wireless competitors toward satisfaction of the Phase I trigger, due to the administrative burdens of determining when mobile wireless serves as a substitute for incumbent LEC wireline service.[512] Should we exclude mobile wireless service from the Phase II trigger, as well? Are there reasons to believe that mobile wireless substitution will be easier or more important to measure in the context of requests for Phase II relief?

203. Some parties, such as Bell Atlantic and USTA, have proposed that we allow incumbent LECs to seek pricing flexibility for these services with respect to certain classes of customer, such as multi-line business customers, based on meeting triggers applicable only to a particular class of customers.[513] We conclude, above, that we should not allow such separate showings for Phase I relief because we wish to encourage competition for both high-volume business customers and residential and low-volume business customers.[514] Should we decline to permit such separate showings for Phase II pricing flexibility for common line and traffic-sensitive services?

2. Relief

204. In the Order, we conclude that an incumbent LEC that qualifies for Phase II relief for dedicated transport and special access services need not comply with Part 69 rate structure rules with respect to these services, may remove these services from price caps, and may file tariffs for these services on one day's notice (so long as such tariffs are made generally available).[515] Should we grant similar Phase II relief for common line and traffic-sensitive service? If not, what relief is warranted upon satisfaction of the Phase II triggers for these services?

205. We also seek comment on whether we should impose certain safeguards with respect to Phase II relief for common line and traffic-sensitive services that we do not impose with respect to dedicated transport and special access services. Currently, incumbent LECs recover some of their common line costs through the SLC, which is assessed directly on the end user. As a condition of granting Phase II relief for common line services, should we require price cap incumbent LECs to charge some or all of the common line charge directly to the end user? If only some of the costs should be charged directly to the end user, on

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[512] *See id.*

[513] Bell Atlantic *ex parte* statement of April 27, 1998, at 27; USTA *ex parte* statement of June 1, 1999, at 2.

[514] *See* Section VI.C.3, *supra*.

[515] *See* Section VI.C.4.c, *supra*.

what basis should we establish a limit? What are the advantages and disadvantages of prohibiting some or all common line cost recovery from IXCs? What additional safeguards might we require? For example, should we limit in any way the extent to which incumbent LECs recover local switching costs from IXCs, as opposed to end users?

206. We also seek comment on the relationship between granting price cap LECs Phase II pricing flexibility for common line and traffic-sensitive services and their receipt of universal service support with respect to these services. If, for example, a price cap LEC is entitled to universal service support for a line if its costs[516] exceed a particular benchmark, should we prohibit the LEC from charging a rate above that benchmark? Similarly, if eligibility for high cost support were determined on the basis of a revenue benchmark, should common line charges be limited by that benchmark? In what other ways should Phase II pricing flexibility for common line and traffic sensitive-services be affected or limited by universal service concerns?

C. Switching Issues

1. Local Switching

a. Introduction

207. We solicit comment on replacing the existing per-minute or per-call local switching rate structure rules with a capacity-based rate structure.[517] Specifically, should we require price cap LECs to charge for local switching on the basis of the number of trunks connected to a given end office switch? Below, we seek comment on a capacity-based local switching rate structure. We then consider adding a factor to the traffic-sensitive PCI formula, designed to serve a function similar to the "g" factor in the common line PCI formula, in order to give access customers a reasonable portion of the benefits of demand growth. Finally, we seek comment on whether to require LECs to decrease their traffic-sensitive PCIs, so that LECs would not retain the benefits of past demand growth on a going-forward basis.

[516] Cost could be determined in a number of ways, including, but not limited to, costs associated with a particular line or a price cap LEC's average cost per line in a study area. *See, e.g., Universal Service Seventh Report and Order*, 14 FCC Rcd at 8126-30.

[517] We address tandem switching issues later in this Order. We do not consider revising Section 69.125, the rate structure rules for dedicated signalling transport services, or Section 69.129, the rate structure rules for signalling for tandem switching. We reviewed our SS7 signalling rate structure rules in the *Access Reform First Report and Order*, 12 FCC Rcd at 16089-91, and we see no reason to re-open those issues at this time.

b. Background

208. The Commission's long-standing policy is to require, to the extent possible, rate structures to reflect the manner in which carriers incur costs. Inefficient rate structures lead to inefficient and undesirable economic behavior, and create an implicit subsidy between high-volume users and low-volume users.[518] For example, a rate structure that recovers non-traffic-sensitive costs through traffic-sensitive access rates increases the per-minute rates paid by IXCs and long-distance companies, thereby artificially suppressing demand for interstate long-distance services, and requiring high-volume customers to pay charges in excess of the costs of providing their service. Meanwhile, low-volume customers pay rates that are less than the cost of the dedicated equipment.[519]

209. The Part 69 rules require incumbent LECs to charge per-minute rates for local switching,[520] based on the Commission's 1983 finding that local switching services were traffic-sensitive.[521] In the *Access Reform First Report and Order*, the Commission recognized that the local switching costs associated with line cards and trunk ports are non-traffic-sensitive,[522] and revised the access charge rate structure to require incumbent LECs to recover those costs through non-traffic-sensitive rates.[523] The Commission also concluded that the record at that time was not adequate to determine whether or to what extent the remaining local switching costs were traffic-sensitive or non-traffic-sensitive, and maintained the requirement that LECs recover those costs through traffic-sensitive rates.[524] The Commission did, however, revise the local switching rate structure to permit, but not require, incumbent LECs to establish per-call local switching charges, in addition to per-minute rates.[525]

210. The Commission also considered the nature of switching costs in the *Local Competition Order*, in the context of establishing pricing rules for local switching unbundled

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[518] *Access Reform First Report and Order*, 12 FCC Rcd at 15995-96, 15998; Investigation of Interstate Access Tariff Non-Recurring Charges, CC Docket No. 85-166, Phase I, Part 3, 2 FCC Rcd 3498, 3501-02 (1987).

[519] *See Access Reform First Report and Order*, 12 FCC Rcd at 15996, 16008.

[520] *See, e.g.*, 47 C.F.R. § 69.106; *Access Charge Order*, 93 FCC 2d at 304 (1983) (*Access Charge Order*).

[521] *Access Charge Order*, 93 FCC 2d at 304-05.

[522] Line cards connect subscriber lines to the switch, and trunk ports connect interoffice trunks to the switch. *Access Reform First Report and Order*, 12 FCC Rcd at 16034.

[523] *Id.* at 16035-36.

[524] *Id.* at 16040.

[525] *Id.* at 16041-46.

network elements (UNEs). At least one party to that proceeding, the Washington Utilities and Transportation Commission, advocated a rate structure based on peak usage for local switching in 1996, arguing that a flat rate based upon the cost of providing capacity at peak load is possibly the most economically correct pricing mechanism.[526] In the *Local Competition Order*, the Commission concluded that shared local switching costs, *i.e.*, local switching costs other than the costs of line cards and trunk ports, could be reasonably recovered through either flat or per-minute rate structures, and permitted state public service commissions to adopt either traffic-sensitive or non-traffic-sensitive rate structures for local switching unbundled network elements (UNEs).[527]

c. Capacity-based Local Switching Rate Structure

211. If costs are driven by peak demand, as suggested by the Washington Utilities and Transportation Commission, then local switching costs do not vary directly with total switched minutes in most cases. In the *Access Reform First Report and Order*, however, the Commission considered and rejected a proposal to require incumbent LECs to develop peak and off-peak rates for local switching, because the Commission concluded that LECs would have difficulty determining peak and off-peak hours with any degree of certainty, due to geographic, user-type, and service considerations. In addition, charging different prices for calls made during different times of the day may cause customers to shift their calling to less expensive times, thereby resulting in different peak times.[528] We know of no reason to revisit our conclusion to reject peak and off-peak rates for local switching. Instead, we consider adopting a capacity-based local switching rate structure. If an increase in total minutes or total number of calls would lead to a measurable increase in local switching costs only when the increase at times of peak demand is so great as to require an expansion of switch capacity, then a capacity-based rate structure may reflect the manner in which incumbent LECs incur local switching costs better than the existing rate structure, without the difficulties raised by determining peak and off-peak hours.

212. A capacity-based local switching rate structure may offer other benefits. Most notably, if IXCs purchased a greater portion of their access services through non-traffic-sensitive rates, they would have an incentive to develop off-peak pricing plans to encourage long distance consumers to make more or longer off-peak calls. This, in turn, would encourage more efficient use of the public switched network. Such pricing plans are also likely to extend a greater share of the benefits of access cost reductions to residential long

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[526] *See* Washington Utilities and Transportation Commission Comments in CC Docket No. 96-98, at 29-30, *summarized in Local Competition Order*, 11 FCC Rcd at 15900.

[527] *Local Competition Order*, 11 FCC Rcd at 15878-79, 15905.

[528] *Access Reform First Report and Order*, 12 FCC Rcd at 16046-47. *See also* Interconnection Between Local Exchange Carriers and Commercial Mobile Radio Service Providers, CC Docket No. 95-185, Notice of Proposed Rulemaking, 11 FCC Rcd 5020, 5042 (1996).

distance customers, because they are more likely than business customers to be off-peak users.

213. Accordingly, we seek comment on revising Section 69.106(f)(2) of the Commission's Rules to require price cap LECs to develop capacity-based local switching charges rather than per-minute charges. For example, should we require price cap LECs to calculate a capacity-based local switching charge by considering the aggregate number of trunks switched by the LEC? If local switching rates are based on number of trunk-side connections, how should we treat local switching access services with line-side connections, such as Feature Group A?[529]

214. We also invite comment on the level of detail that we should specify in our local switching rate structure rules. Specifically, should Section 69.106 require incumbent LECs to charge for local switching based on the DS-1 equivalent capacity of an access customer's trunks connected to a particular end office switch, so that the DS-3 charge would be 28 times the DS-1 charge? Should we instead establish some initial rate relationship between DS-1 and DS-3, as the Commission did for transport?[530] Is there some other rate structure we could prescribe that would better reflect how local switching costs vary with increases in peak demand that necessitate expansion of switch capacity? Alternatively, should we permit LECs to develop their own capacity-based local switching rate structures, and examine the reasonableness of those structures in the tariff review process?

215. We tentatively conclude that a capacity-based local switching rate structure, if it indeed reflects cost causation, would not artificially disadvantage smaller IXCs in the market for long distance services. As the Commission concluded in its decision to eliminate the unitary rate structure for tandem-switched transport, rules that protect small IXCs in competition with AT&T, or other large IXCs, are unnecessary because the long-distance market is competitive.[531] We seek comment on this conclusion.

216. In addition, we invite parties to comment on whether permitting volume and term discounts for switched access services, as we propose above, would exacerbate any negative impact for smaller IXCs. We invite comment on whether a resale market for local

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[529] For purposes of this Order, Feature Group A is line side access to telephone company end office switches with an associated seven digit telephone number for the customer's use in originating communications from and terminating communications to an IXC's interstate service or a customer-provided interstate communications capability. *See* Contel of Indiana, Inc., Memorandum Opinion and Order, 3 FCC Rcd 4298, 4303 n.5 (Com. Car. Bur., 1988) (*citing* Exchange Carrier Association Tariff F.C.C. No. 1, pp. 157-59).

[530] The Commission adopted a presumption of reasonableness for initial transport rates if incumbent LECs developed DS-3 and DS-1 rates with a ratio of 9.6-to-1. *See* 47 C.F.R. § 69.108, Transport Rate Structure and Pricing, CC Docket No. 91-213, First Reconsideration Order, 8 FCC Rcd 5370 (1993).

[531] *Access Reform First Report and Order*, 12 FCC Rcd at 16060.

switching services is likely to develop, and whether such a development would mitigate any negative impact that smaller IXCs might face. We note that the Commission already has a policy prohibiting carriers from placing restrictions on resale in their tariffs.[532] We invite comment on whether any further resale protection is necessary. Alternatively, we invite comment on whether we should permit or require incumbent LECs to retain existing per-minute or per-call local switching charges concurrently with non-traffic-sensitive charges. Finally, we invite parties to make other proposals.

d. Revision of Traffic-Sensitive PCI Formula

217. In the *LEC Price Cap Order*, the Commission concluded that it needed to adopt a formula for the common line basket PCI different from the PCI formula for the other baskets, to reflect that carrier common line rates are traffic-sensitive even though common line costs are non-traffic-sensitive.[533] Accordingly, the Commission included a "g" factor in the common line PCI formula, where g represents per-minute growth per access line.[534] The Commission found that including g would give all the benefits of demand growth to IXCs, while excluding g would give all the benefits of demand growth to LECs.[535] The Commission incorporated g/2 as a compromise, because it found that both IXCs and LECs contribute to demand growth.[536] The Commission did not attempt to measure at that time the relative contributions to demand growth made by IXCs and LECs, and expressly stated that a 50-50 split was not a precise reflection of the LECs' ability to influence usage.[537]

218. If we decide to adopt a capacity-based local switching rate structure, it may be appropriate to include a factor in the traffic-sensitive PCI formula similar to the g factor currently in the common line PCI formula. Although, as discussed above, it is possible that a capacity-based local switching rate structure reflects costs better than a per-minute rate

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[532] Resale and Shared Use of Common Carrier Services and Facilities, 60 FCC 2d 261 (1976), *cited in, e.g.*, Metro Communications, Inc., v. Ameritech Mobile Communications, Inc., 12 FCC Rcd 13083, 13092 (Wireless Tel. Bur., 1996).

[533] *LEC Price Cap Order*, 5 FCC Rcd at 6793.

[534] Id. at 6794. The g factor is defined as "the ratio of minutes of use per access line during the base period, to minutes of use per access line during the previous base period, minus 1." *See* Section 61.45(c)(1) of the Commission's Rules, 47 C.F.R. § 61.45(c)(1).

[535] *LEC Price Cap Order*, 5 FCC Rcd at 6794. Setting g at zero would mean that the common line PCI is unaffected by demand growth. In this case, the LEC would keep all the increased revenue resulting from that demand growth. Alternatively, incorporating a "full g" into the common line PCI would require LECs to reduce their common line PCIs to reflect all demand growth. In this case, the IXC would receive all the benefits of demand growth in the form of lower common line rates.

[536] *Id.* at 6795.

[537] *Id.*

structure, capacity-based rates may not reflect local switching costs perfectly. More specifically, an increase in the number of trunks at a switch may not lead to a proportional increase in local switching costs. Rather, such an increase in trunks may lead to a measurable increase in local switching costs only when the increase of peak demand is so great as to require an expansion of switch capacity. If this is the case, then local switching costs may not vary directly with changes in per-trunk demand. We tentatively conclude that it would not be reasonable to permit incumbent LECs to retain all the benefits of trunk growth if they are not exclusively responsible for encouraging that growth. Accordingly, we invite parties to discuss whether the traffic-sensitive PCI formula should include a "q" factor, similar to the "g" factor in the common line PCI formula, to incorporate growth in number of trunks into the traffic-sensitive PCI formula. We also invite comment on whether to adopt a q factor if we decide not to revise the local switching rate structure as proposed above, or if we permit or require LECs to offer both usage-sensitive and capacity-based local switching rates.

219. We also request comment on the definition of this q factor if we decide to adopt it. For example, should it be based on the change in DS-1 equivalent capacity? Should price cap LECs measure changes in DS-3 equivalent capacity on some basis other than DS-1 equivalents? We intend to base any q factor we adopt on data that price cap LECs currently collect, or data that price cap LECs could collect at little or no additional cost. We therefore invite any party proposing a q factor definition to discuss whether and to what extent its definition would affect price cap LECs' data collection costs.

220. We also invite comment on the relationship between any q factor we add to the traffic-sensitive PCI formula and the g factor in the common line PCI formula. Specifically, the common line PCI formula currently includes "g/2", because the Commission found in the *LEC Price Cap Order* that both LECs and IXCs contribute to demand growth, and that "g/2" gives both IXCs and LECs a reasonable share of the benefits of per-minute demand growth.[538] We note that we invite comment below on increasing the g factor in the common line PCI formula from g/2 to a full g.[539] We therefore invite comment on whether any q factor we adopt for the traffic-sensitive PCI formula should be consistent the common line g factor, as revised in this proceeding. Alternatively, we invite comment on whether we should base the q factor in the traffic-sensitive basket on a different fraction than the common line g factor, because local switching does not make up all of the traffic-sensitive basket.[540]

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[538] *Id.*

[539] *See* Section VIII.D.1, *infra.*

[540] The services other than local switching in the traffic-sensitive basket are: (1) information; (2) database access services; (3) billing name and address (BNA); (4) trunk ports; and (5) signalling transfer point port termination. *See* Section 61.42(e)(1) of the Commission's Rules, 47 C.F.R. § 61.42(e)(1). These services generate less revenue than local switching. Local switching generally makes up about 2/3 or 3/4 of the revenues associated with the traffic-sensitive basket.

e. Adjustment to Traffic-Sensitive PCIs

221. In the *LEC Price Cap Order*, the Commission concluded that failing to include a "g" factor in the common line PCI formula would not give IXCs any incentive to become more productive through encouraging demand growth.[541] In other words, failure to include "g" would have created an imbalance between the interests of IXC customers and LEC stockholders. This imbalance would have been substantially similar to the imbalance found by the Commission in the 1995 *LEC Price Cap Performance Review Order*. In that Order, the Commission found that it had previously set the X-Factor lower than it intended, due to the inclusion of 1984-85 data in one of the original X-Factor studies.[542] The Commission observed that LECs were supposed to become more efficient to earn more than would have been permitted under rate-of-return regulation, and ratepayers were to benefit from rates reduced to the level that would provide this challenge.[543] The Commission then concluded that some portion of the LECs' earnings were obtained without any productivity improvements, and rates were not as low as the Commission intended.[544]

222. If we find that local switching costs are more appropriately recovered through capacity-based charges, then permitting LECs to charge per-minute local switching rates since LEC price cap regulation was adopted in 1991, without including a q factor in the traffic-sensitive PCI formula, may have created an imbalance between the interests of IXC customers and LEC stockholders, similar to the imbalance found in the *LEC Price Cap Performance Review Order* resulting from the 1984-85 data discussed above.[545] The existing per-minute rate structure provides the incumbent LEC with more revenue whenever per-minute demand increases, regardless of whether the LEC's costs have increased. This revenue increase results in higher earnings for the LEC, regardless of whether it has become more productive in its provision of local switching. This could explain, at least in part, why overall LEC earnings have increased in recent years, even though the Commission increased the X-Factor in 1995 and 1997. Furthermore, such an imbalance would remain embedded in the incumbent LECs' traffic-sensitive PCIs, regardless of whether we correct it by revising the local switching rate structure or including a q factor in the traffic-sensitive PCI formula on a forward-looking basis. Moreover, using per-minute charges without simultaneously using a q factor may have exacerbated this imbalance. Accordingly, we seek comment on whether to require a one-time downward adjustment of the LECs' traffic-sensitive PCIs to correct for any imbalance on a

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[541] *LEC Price Cap Order*, 5 FCC Rcd at 6795.

[542] *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9069.

[543] *Id.* at 9070.

[544] *Id.*

[545] *See* AT&T *ex parte* statement of Feb. 19, 1999, at 6 (alleging a 45 percent rate of return for all price cap LECs in the traffic-sensitive basket).

going-forward basis, similar to the adjustment required in the *Price Cap Performance Review Order*.[546] Specifically, price cap LECs were required to reduce their PCIs to the levels that would have resulted had the Commission excluded the 1984 data point in its 1990 X-Factor determination. In this proceeding, we invite comment on whether price cap LECs should be required to reduce their traffic-sensitive PCIs to the levels that would have resulted had the Commission incorporated a q factor in the traffic-sensitive PCI formula that took effect in 1991. Alternatively, we invite comment on basing this PCI adjustment on a more recent year.

2. Tandem-Switched Transport

223. We solicit comment on whether we should revise the rate structure for tandem-switched transport, for the same reasons we consider revising the local switching rate structure discussed above.[547] We also invite comment on all the issues we discussed in this section above, to the extent that they are relevant to tandem switching. Is tandem-switched transport different from local switching, such that capacity-based tandem switching rates are inappropriate? If capacity-based tandem switching rates are appropriate, how would they be developed? For example, they could be established based on the number of trunks between the IXC POP and the tandem switch.

224. If the tandem switching rate structure should remain usage-based, how could we prevent larger IXCs from maintaining an inadequate number of trunks to the LEC switch, and using tandem switching as inexpensive overflow? Could LECs establish a rate for IXCs that only use tandem-switched transport, and recover a higher rate for overflow from local switching? If so, we recognize that IXCs rely exclusively on tandem switching for certain routes, and so we believe that an overflow rate should be applied only on routes for which an IXC also has trunks to the local switch.

225. In addition, we invite parties to discuss whether we should add a q factor to the trunking basket PCI, if we conclude that tandem switching costs are more appropriately recovered through capacity-based rates. If so, how should that q factor be defined? Parties may also discuss whether we should adjust the trunking basket PCI to reflect that price cap LECs have recovered essentially flat costs through traffic-sensitive rates since LEC price cap regulation took effect in 1991, similar to the traffic-sensitive PCI adjustment we propose above.

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[546] *Price Cap Performance Review Order*, 10 FCC Rcd at 9069-73. *See also Bell Atlantic v. FCC*, 79 F.3d at 1204-05 (affirming *Price Cap Performance Review Order* on this issue).

[547] *See* Section VIII.C.1.c, *supra*.

D. Price Cap Issues

1. Common Line Issues

a. G Factor

226. The Commission proposed revisions to the common line formula in the *Price Cap Fourth FNPRM*, which established part of the record for the *Price Cap Fourth Report and Order*.[548] The Commission decided against revising the common line formula in the *Price Cap Fourth Report and Order*, however, because it expected the common line PCI formula to be eliminated when per-minute CCL charges were eliminated, as a result of rules adopted in the *Access Reform First Report and Order*.[549] The transition away from per-minute CCL charges, however, is progressing slowly for certain incumbent LECs. Accordingly, we take this opportunity to review some of the common line issues addressed in the *Price Cap Fourth Report and Order*.

227. Above, we explain why the Commission included a "g/2" term in the common line formula when it adopted LEC price cap regulation.[550] Later, in 1995, the Commission found evidence that IXCs influence per-minute demand growth more than LECs, and considered increasing the g factor to reflect the IXCs' greater contribution to demand growth.[551] The Commission did not revise the common line formula at that time, however, because it found that the separate common line formula could be eliminated completely if it adopted a moving average TFP-based X-Factor. The moving average X-Factor would incorporate the effects of growth into the PCI, and a separate g factor would no longer be necessary.[552] Although the Commission did not adopt a moving average-based X-Factor in the 1997 *Price Cap Fourth Report and Order*, it nevertheless decided against revising the common line formula, because the Commission expected per-minute CCL rates and the separate common line formula to be phased out relatively quickly as a result of common line

[548] *Price Cap Fourth FNPRM*, 10 FCC Rcd at 13680-81.

[549] *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16710 (citing *Access Reform First Report and Order*, 12 FCC Rcd at 16027). In the *Access Reform First Report and Order*, the Commission adopted rules to phase out per-minute CCL charges through imposition of PICCs, and to replace the current common line PCI formula with the formula used for other PCI baskets when per-minute CCL charges are eliminated. *Access Reform First Report and Order*, 12 FCC Rcd at 16027-28).

[550] Section VIII.C.1.d, *supra*.

[551] *LEC Price Cap Performance Review Order*, 10 FCC Rcd at 9078-80.

[552] *Id.* at 9079-80.

rule revisions adopted concurrently in the *Access Reform First Report and Order*.[553] Our access reform rules have not eliminated per-minute CCL charges for some companies as quickly as the Commission had anticipated. As a result, this issue warrants re-examination. We invite comment on whether the g factor in the common line PCI formula should be increased, and if so, whether it should be increased to a full "g." Increasing the "g" factor would cause the common line PCI to decrease more quickly, which in turn would cause the per-minute CCL rate to decrease more quickly. The g factor would still be eliminated when the CCL is eliminated in the access reform transition. Parties advocating a "g" factor between g/2 and g should specify what fraction of g they believe should be included in the common line PCI formula, and explain their reasons.[554]

b. Reflection of Revised Common Line Rate Structure in Common Line Formula

228. We have determined that as long as the multi-line business PICC exists, to the extent that the ratio of primary residential and single line business lines to non-primary residential and multiline business lines changes, the common line formula may create a windfall or shortfall for some LECs. Accordingly, we seek comment on revising the common line PCI rules to eliminate any such windfall or shortfall.

229. Prior to the *Access Reform First Report and Order*, price cap LECs recovered all their common line revenues through two charges: (1) flat monthly end user common line charges (EUCL), also known as SLCs, imposed on end users; and (2) per-minute CCLCs imposed on IXCs.[555] In the *Access Reform First Report and Order*, the Commission prescribed new flat common line rate elements, called PICCs, to be imposed on IXCs in most cases.[556] PICC charges were designed to recover some of the revenues formerly recovered through per-minute CCL charges, and to annually increase until the per-minute CCL charge is phased out.[557]

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[553] *Price Cap Fourth Report and Order*, 12 FCC Rcd at 16709-10; *Access Reform First Report and Order*, 12 FCC Rcd at 16027-28.

[554] The current rules require price cap LECs to replace the current common line PCI formula with the formula used for other PCI baskets when they eliminate per-minute CCL charges. *Access Reform First Report and Order*, 12 FCC Rcd at 16027-28; Section 61.45(c)(2) of the Commission's Rules, 47 C.F.R. § 61.45(c)(2). We do not contemplate revising the rules to permit or require price cap LECs to use the separate common line PCI formula after they have eliminated per-minute CCL charges.

[555] *See Access Reform First Report and Order*, 12 FCC Rcd at 16018.

[556] *Id.* at 16019-26. Incumbent LECs are permitted to impose PICC charges directly on end users that do not select a presubscribed interexchange carrier (PIC). *Id.* at 16019.

[557] *Id.* at 16023.

230. PICCs on single-line business and primary residential lines were set initially so that the sum of the PICC and SLC applicable to each of these lines was less than the average revenue per line permitted under the price cap rules.[558] Those PICCs will increase until the sum of the applicable PICC and SLC is equal to the maximum permitted revenue per line.[559] During the interim, price cap LECs are allowed to recover this shortfall through PICCs on multiline business lines. As a result, during this interim period, single-line business and primary residential lines receive an explicit subsidy from multiline business lines.[560]

231. The growth rate of the amount received through this PICC subsidy ideally should be equivalent to the growth rate of primary residential and single-line business lines. The PICC subsidy, however, will grow too quickly or too slowly whenever the lines giving subsidy, multiline business lines,[561] grow at a different rate than the lines receiving subsidy, single-line business and residential lines. This subsidy increases disproportionately if multiline business lines grow more quickly than single-line business and primary residential lines. This subsidy fails to keep up with line growth if multiline business lines grow less quickly than single-line business and primary residential lines.

232. For example, assume that the average permitted revenue per line in Year 1 is $6, and that the LEC provides 50 residential lines and 50 multiline business lines. Thus, the LEC is permitted $300 in revenue for residential lines (50*6), and $300 in multiline business lines (50*6). Assume also that the caps on SLCs and PICCs permit the LEC to collect $4 for each residential line, and $8 for each multiline business line. In this case, residential line charges recover only $200 in revenue, and so need $100 in subsidy. Multiline business lines recover $400 of revenue, and so generate $100 in subsidy. In this case, there is no windfall or shortfall in subsidy, and the LEC recovers an average of $6.00 per line. Now assume that, in Year 2, multiline business lines grow from 50 to 70, while residential lines remain at 50, and everything else in Year 1 remains the same. In this case, residential lines still require $100 in subsidy. The LEC, however, would collect $560 in revenue from each multiline business line (70*8). As a result, multiline business charges generate $160 in subsidy. Because the LEC's residential lines require only $100 in subsidy, the LEC receives a windfall of $60 in this example, and would recover an average of $6.33 per line. Thus, under our current rules,

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[558] *Id.* at 16020-21.

[559] *Id.*

[560] *Id.* at 16022. In some study areas, some or all of the non-primary residential PICC may also subsidize primary residential lines, depending, among other things, upon the relationship of the carrier common line revenues per line and the cap on the non-primary residential SLC. In addition, if PICCs on multiline business lines still do not enable a price cap LEC to recover all its permitted common line revenue, the LEC may recover those residual revenues through per-minute CCL charges assessed on originating minutes. *Id.*

[561] As discussed above, non-primary residential lines also provide subsidy in some cases, and so the growth rate of non-primary residential lines also affects this subsidy.